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Supreme Court of the United States

OCTOBER TERM, 1975.

No. 74-1471

TSC INDUSTRIES, INC., A DELAWARE CORPORATION, NATIONAL INDUSTRIES, INC., A KENTUCKY CORPORATION, AND TSC INDUSTRIES, INC. (FORMERLY NAMED NII, INC., AND BEING THE SUCCESSOR TO THE BUSINESS, ASSETS AND CORPORATE NAME OF SAID TSC INDUSTRIES, INC.), A DELAWARE CORPORATION,

Petitioners,

vs.

NORTHWAY, INC., A DELAWARE CORPORATION,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITIONERS' REPLY BRIEF.

JOSEPH N. MORENCY, JR.,
JAMES T. OTIS,
WESLEY S. WALTON,
JOHN R. F. BAER,
Keck, Cushman, Mahin
& Cate,
8300 Sears Tower,
233 South Wacker Drive,
Chicago, Illinois 60606,
312/876-3400,
Attorneys for Petitioners.

Of Counsel:
MILTON V. FREEMAN,
WERNER J. KRONSTEIN,
Arnold & Porter,
1229 Nineteenth Street, N. W.,
Washington, D. C. 20037.

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

I.

THE OMISSIONS COMPLAINED OF DID NOT MAKE THE PROXY STATEMENT FALSE OR MISLEADING IN ANY MATERIAL RESPECT.

(Reply to Respondent's Brief pp. 6-10, 11-61, 78-81 and SEC Brief pp. 17-24.)

The critical issue in this Court is whether, within the framework of this summary judgment record and the limitations of Rule 56, F. R. Civ. P., the court below could properly find that certain omitted information was so essential to fair pre-

sentation of the required subject matter that its nondisclosure rendered the Proxy Statement itself false and misleading in violation of Rule 14a-9 of the proxy rules.

Respondent ("Northway") misses the point with its extended discussion and argument about evidentiary facts relating to the four complained of omissions. Merely establishing the relevancy of an omitted fact is not enough to bring the Proxy Statement within the proscription of Rule 14a-9 on this summary judgment record. Much more is needed: Northway must show that, beyond factual dispute, an omitted fact was necessary to fair presentation of the subject matter and that leaving it out rendered the Proxy Statement false or misleading in a material respect.

All of the information specified in Schedule 14A, Item 14, of the SEC's proxy rules was disclosed.[1]

Rule 14a-9 by its terms[2] is violated only when (1) the omitted fact itself is material *and* (2) its omission makes the disclosures of the proxy statement itself (as a matter of law on this summary judgment record) false and misleading in a material respect.[3] There are no such violations here.

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1. Neither the District Court nor the Seventh Circuit found Northway was entitled to summary judgment for violation of Rule 14a-3. 361 F. Supp. at 111; 512 F. 2d at 329.

2. Rule 14a-9 provides:

> "No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

3. *Crane Co.* v. *Westinghouse Air Brake Company*, 419 F. 2d 787, 799-800 (2d Cir. 1969), *cert. denied*, 400 U. S. 822 (1970). Pet. Br. pp. 27-29.

A. Restatement of the Decisive Facts.

Brief recitation of the decisive facts shows that the allegedly material omissions on which Northway built its case do not even *remotely* qualify as violations of Rule 14a-9. The complained of omissions are minor and subsidiary facts. They are not, as required by the Rule, important, consequential or dramatic and their omission does not operate to create a false impression as to essential characteristics of the transaction.

The original complaint in this action was filed on December 4, 1969, the day before the stockholders' meeting. It alleged a conspiracy between National and the National-controlled directors of TSC to cheat the general body of shareholders of TSC by agreeing to an unfair deal which would give the TSC shareholders far less for their stock than it was worth.

Obviously because of a lack of sufficient evidence to prove these allegations, Northway did not seek interim relief to prevent consummation of the transaction. Instead, it allowed the transaction to close and watched while post-closing changes in the business progressed and trading went on in the securities for years.

Subsequent intensive discovery by Northway failed to develop evidence to support the allegations that the TSC shareholders were cheated and Northway makes no pretense to the contrary. Absent any such evidence, Northway effectively abandoned its fraud allegations and, in July 1972, moved for partial summary judgment on the theory that certain omissions of minor facts (1) concerning the possibility of National's influencing the decisions of TSC and (2) allegedly touching on the market prices of National's securities made the Proxy Statement so misleading that, had they been disclosed, the shareholders might have refused to approve the transaction because they might have suspected that they were being cheated. Northway thus sought to achieve by indirection (successfully in the Seventh Circuit) what it could not achieve on the merits, be-

cause proof of the substantive allegations of fraud could not be found.

The reason that such proof could not be found is plain. As discussed in our principal Brief at pp. 13-14, 35, the record, even in its present incomplete form, establishes plainly that the essential terms of the transaction were not dictated by National, but were determined by an independent investment banker on the board of TSC.

It was Mr. Noyes, a member of the investment banking firm of Hornblower & Weeks-Hemphill, Noyes ("Hornblower"), who proposed the terms of the transaction which National accepted without argument, discussion or attempts to negotiate.[4] Mr. Noyes and his firm had no connection with National. His firm had recently underwritten a public offering of 195,000 shares of TSC common stock and he himself was a holder of both preferred and common stock of TSC, and his wife was also a holder of common stock (A. 267).

It was Mr. Noyes and three other TSC directors not connected with National who voted TSC's approval of the transaction (A. 414). The three National directors present at the meeting did not vote although they stated they were in accord with the proposal, expressly excusing themselves on advice of counsel, as did one other non-National TSC director.

Northway vigorously complained in the courts below (and reiterated the same argument here (Br. p. 5)) that since only the four disinterested directors out of a total board of ten directors voted and four directors who were present abstained, there was not proper authorization of the transaction under Delaware law. The District Judge rejected this contention and the Court of Appeals held that Northway failed to establish

4. Despite this clear record, the SEC Brief (p. 6) blandly asserts that "National formulated a proposed merger of TSC into National . . ." and "The TSC board of directors apparently approved the proposal. . . ." Wholly ignored is the fact that Noyes rejected a previous National proposal as not sufficiently favorable for TSC's shareholders. See pp. 29-31 Petitioners' Brief.

materiality of the method of director voting.[5] Terms of the transaction were determined at arm's length and not under National's influence.

This is the context in which the four alleged omissions in the Proxy Statement must be viewed. Northway's extensive arguments relating to these omissions are discussed herein as Points II (pp. 14-22), III (pp. 23-32) and IV (pp. 33-36). Review of a few key facts points up the true insignificance of these four omissions.

1. The fact that Mr. Noyes determined the terms of this particular transaction would seem to remove any possible significance from the alleged omissions of facts touching on the possibility which National generally might have had of influencing other kinds of TSC decisions. With respect to this transaction, it is plain the terms of the exchange were not subject to any such influence.[6]

Furthermore, the omissions relied upon by Northway were of facts obviously of subsidiary significance to the disclosures prominently made in the Proxy Statement that (i) National had a 34% interest in TSC, (ii) no other shareholder had more than a 10% interest in TSC and (iii) National's five nominees on TSC's ten-man board of directors were plainly identified by name and the positions they each held in National.

The specific omissions alleged by Northway are that (1) the Proxy Statement did not disclose the titles of two of the National nominees on the TSC board—as chairman of the board and chairman of the board's executive committee, respectively, and (2) did not refer to prior filings with the SEC stating

5. 361 F. Supp. at 114-115; 512 F. 2d at 338.

6. It is astonishing that the Court of Appeals said that National sat on both sides of the table in setting the terms of the exchange. 512 F. 2d at 333. Compare Petitioners' principal Brief pp. 29-31. Equally surprising is SEC's comment on the "purported objectivity" of the TSC board (SEC Br. p. 23) in recommending the transaction to the TSC shareholders. Neither the court below nor SEC's lawyers were inhibited by Rule 56(c).

that National may be deemed to be a "parent" of TSC—*i.e.*, a parent in control of TSC.

These omissions have no relevance to the issue before this Court, namely, whether the Proxy Statement disguised improper influence which may have been exercised by National *in connection with this particular transaction*. The terms were formulated by an independent director of great financial experience who was not connected in any way with National, and approved unanimously by disinterested directors also not connected with National. The record shows that National and its representatives on the TSC board did not even attempt to influence the terms of the transaction and accepted the counterproposal of Mr. Noyes without argument.

The courts below expressly refused to find National in control of TSC on the basis of this summary judgment record. Accordingly, for purposes of this motion, National must be assumed *not* to be in control of TSC.

Furthermore, under the circumstances here, the filings indicating the possibility of control are of no significance since the control, if it existed, was plainly not exercised for purposes of the transaction in question. The concept of control is multifaceted. Control for one purpose (such as the need to comply with the registration requirements of the 1933 Act) is not control for every purpose. Thus, for example, a power to veto a transaction which this Court held to constitute control in *Rochester Telephone Corp.* v. *United States*, 307 U. S. 125 (1939), would not, obviously, constitute control for purposes of affirmatively dictating the terms of a merger.

Northway's apparent efforts to build these minor omissions into a case of concealment of control are plainly unavailing.

2. Northway also alleges that the shareholders were misled in two respects as to the value of the National securities to be exchanged for TSC stock.

Northway says, in effect, that the Proxy Statement, by reference to one of the bases for Hornblower's favorable opinion,

promised the TSC shareholders a "substantial premium" in the form of the current market prices of the National securities to be received by them. It contends that the premium which was, in fact, received was less than substantial. We deal with the intricacies of this argument, to which Northway devotes substantial effort, below in Point III (pp. 23-32).

One fact which Northway carefully ignores stands out clearly. The transaction was, in fact, received by the market as providing a substantial premium to the TSC shareholders.

Mr. Noyes testified that the October 16, 1969 recommendation made by Hornblower was based on early October market values (before public announcement of the proposal) of 16 for National preferred, and 11⅝ and 11 for TSC common and preferred, respectively. He explained that once the terms of the exchange were announced, the market prices of the TSC shares moved up. The Proxy Statement which was dated November 12, 1969, several weeks later, contained the market quotations for November 7, 1969, showing the common stock of TSC had risen in the market from 11⅝ to 13¼ and that the preferred had risen from 11 to 12, while the National preferred stock remained about the same—16⅝.

Clearly the market confirmed the correctness of Hornblower's view that the package of National securities would give TSC shareholders a substantial premium over the then current market value of their TSC securities. The amount of that premium must, of course, be calculated on the basis of the market prices before the announcement of the transaction was made and not after the market has had an opportunity to discount the premium.[7]

Northway also argues that the market price for the common stock of National may have been affected by insufficiently disclosed market purchases of National and/or undisclosed pur-

7. Thus, for example, if a tender offer is made to buy stock from the public for $30 when the market is $25, and then the market reacts and the price goes to $29, it is not fair to say that the offer of $30 is merely $1 above the market price.

chases by an unaffiliated mutual fund with some related personnel.

The common stock of National was not involved in the transaction; instead the package of securities for the TSC shareholders was principally National Series B preferred stock with some National warrants. The court below did not find that there was evidence establishing, for purposes of the summary judgment motion, that the purchases of the mutual fund were coordinated with National.[8]

Plainly lacking is any evidence establishing the effect, if any, these purchases may have had on the market price of National's common stock, which was declining during 1969. Wholly absent is any evidence of the effect of the market price of the common on the market price of the National warrants, which were to be issued in that transaction.

In such circumstances, Rule 14a-9 does not require disclosure of such purchases to enable stockholders to speculate as to the possible remote effect of such market transactions on the fairness of the transaction which was, as discussed above, independently arrived at and approved at arm's length.

B. The Appropriate Standard Under Rule 14a-9.

The legislative history of Section 14 of the 1934 Act (outlined at pp. 18-24 Petitioners' Brief) makes it perfectly clear that, for Rule 14a-9 to be violated, it must be shown that the absence of the omitted fact so seriously distorted the factual disclosures actually made in the proxy statement as to give shareholders a false impression as to the basic nature of the matters on which they are being called upon to vote. Omissions of minor matters, even those whose disclosure might seem desirable, are not intended to be reached by the Rule. Rule 14a-9 is basically structured to prevent major omissions which result in fraud, not to

8. 512 F. 2d at 336: "While we agree that collusion is not conclusively established by the omitted facts, it is certainly suggested."

impose liability for the omission of matters of minor or subsidiary importance whose disclosure is not specifically required by the SEC's rules.

Rule 14a-9 is derived from similar provisions in the Securities Act of 1933 dealing with false and misleading statements in registration statements. See Sections 11, 12(2) and 17 of the 1933 Act. To a significant extent those antifraud provisions of the 1933 Act were based upon the prior English experience and precedents, particularly the well-known and then current decision in the *King* v. *Kylsant* (Lord), [1932] 1 K. B. 442 (1931). Houston Thompson, who was one of the authors of the 1933 Act and a former member of the Federal Trade Commission, testified that:

> "Now, in the preparation of this bill we had a number of proposals so far as legislation is concerned before us. We had the British act before us. We had this case of Lord Kelsant before us—the *King* v. *Kelsant*—which arose under the British act; and, if you recall, several months ago Lord Kelsant was sent to prison for violation of the act. It is rather interesting to note that he was sent to prison for failing to give the information that he should give; in other words, for concealing information." Hearings on H. R. 4314 before the Committee on Interstate and Foreign Commerce, 73rd Cong., 1st Sess. 11 (1933).

Kylsant is a classic example of an omission which makes the related statement actually made false and misleading in a material respect. Lord Kylsant was chairman of a shipping company which issued a prospectus relating to the issue of 5% debenture stocks. The prospectus stated that the "audited accounts of the company show that during the past ten years the average annual balance available . . . has been sufficient to pay the interest on the present issue more than five times over." The prospectus also contained a table showing that the company paid dividends every year since 1911 but one.

Those statements in the prospectus were literally true as far as they went; however, they were made seriously deceptive by

the failure of the prospectus to state that although the company had made "very large profits in 1918, 1919 and 1920", in the years 1921-27 substantial trading losses were suffered. Accordingly, during the six years prior to the offering, the company did not have sufficient current income available to meet the interest on the debentures or for the payment of dividends.

The British court held the prospectus was "false in a material particular in that it conveyed a false impression," and stated (at p. 448):

> "The falsehood in this case consisted in putting before intending investors, as material on which they could exercise their judgment as to the position of the company figures which apparently disclosed the existing position, but in fact hid it."[9]

The SEC appreciated the importance of *Kylsant* in the evolution of the 1933 Act and cited *Kylsant* in its first decision on the question of whether an omission in a registration statement makes it materially false and misleading. *In the Matter of Charles A. Howard*, 1 S. E. C. 6 (1934), the SEC observed:

> ". . . the half-truth embodied in the registrant's answer [to an item in the registration statement] is the very type of untruth to which the language of the Securities Act relating to omissions of material fact has reference. In the language of Mr. Justice Avory, the registrant's statement is 'false in

9. The legislative history of the 1933 Act also clearly demonstrates the express Congressional concern to assure that a "mere omission" will not be the basis for liability, but that liability could be imposed only where the omission makes the registration statement itself misleading. The Conference Report, H. R. Rep. No. 152, 73rd Cong., 1st Sess. 26 (1933), notes that the House Bill "made the liability depend upon the making of untrue statements or omissions to state material facts." It says that "[t]his phrase has been clarified in the substitute to make the omission relate to the statements made in order that these statements shall not be misleading, rather than making the mere omission . . . a ground for liability where no circumstances exist to make the omission in itself misleading."

> a material particular in that it conveyed a false impression.' *Rex* v. *Kylsant* [1932] 1 K.B. 442, 448."[10] 1 S.E.C. at 11.

Both the language used and the regulatory purpose of Section 14(a) of the 1934 Act[11] make it clear that Rule 14a-9 calls only for information whose absence, in *"the light of the circumstances"* and in the context of the entire proxy statement read fairly, so distorts the disclosures actually made[12] as to make such disclosures themselves false and misleading in some important respect.

Kylsant and the related SEC decision in *Howard* accurately reflect the legislative purpose and thus constitute a yardstick against which allegations that an omission constitutes a violation of SEC Rule 14a-9 must be measured.[13]

10. Judge McLean in *Escott* v. *BarChris Constr. Corp.*, 283 F. Supp. 643, 681 (S. D. N. Y. 1968), commented that the definition of materiality stated in *In the Matter of Charles A. Howard* "is still valid today."

11. Developed at pp. 18-24 of Petitioners' Brief; also see remarks of Congressman Mapes of Michigan who explained the object of the legislation by referring directly to the strong dissent of Justice Stone in *Rogers* v. *Guaranty Trust Co.*, 288 U. S. 123, at 138-139, 141-142 (1933), where American Tobacco Company shareholders were hoodwinked into approving excessive stock options for management through a deceptive proxy solicitation. 78 Cong. Rec. 7822-23 (1934) (remarks of Rep. Mapes).

12. A distortion which frustrates the free exercise of shareholders' voting rights because they are not given an explanation as to "the real nature of the questions" for which authority to cast his vote is sought. *J. I. Case Co.* v. *Borak*, 377 U. S. 426 at 431 (1964). To the same effect see SEC Exchange Act Release No. 1350 (August 13, 1937), entitled "Statement by Commission with respect to the purpose of the disclosure requirements of Section 14 and the rules adopted thereunder," which stated:

> "The purpose of these rules is to prevent the dissemination to the security holders and to the general public of untruths, half-truths, and otherwise misleading information which would stand in the way of a fair appraisal of a plan upon its merits by the security holders."

13. This yardstick is consistently applied in determining materiality in the three major post-1934 materiality cases, *Texas Gulf Sulphur*, *Cady Roberts* and *Merrill Lynch* (cited and described in Pet. Br. pp. 26-27 and n. 21), each of which dealt with concealment

Recent decisions of this Court involved the concealment or omission of truly important facts. In *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128, *reh. denied*, 407 U. S. 916, 408 U. S. 931 (1972), bank officials, under circumstances where there was a duty to disclose, purchased securities without advising the seller that the prevailing market price was *far in excess* of the purchase price paid by the bank or that they were dual agents. And *Mills* involved, in this Court's own words, a "failure to reveal [in a merger proxy statement] a serious conflict of interest on the part of the directors . . . thwarting the informed decision at which the statute aims."[14]

An extension of Rule 14a-9 to create liability for omissions which do not have any major impact on the matter to be voted on by shareholders would be clearly inconsistent with the purpose and intent of the Rule. Absent a clear focus on the real-life importance of the omission, the courthouse doors are wide open to claims based on nothing more than the ingenuity and imagination of counsel, combing through proxy statements with the benefit of 20-20 hindsight, and second-guessing the good faith judgments made by the issuer and its counsel in the preparation of proxy statements.[15] The omitted information, to give rise to liability under Rule 14a-9, must be of such obvious consequence that its omission is outside of the range of permissible judgments. Paraphrasing a statement Judge Weinfeld made in a recent tender offer case,[16] unless there is a " 'reasonable area of discretion . . . in deciding what facts need to be disclosed' ", proxy statements would "become something akin

or misuse of information which was of undoubted and dramatic significance to investors.

14. *Mills* v. *Electric Auto-Lite Co.*, 396 U. S. 375 at 384 n. 6 (1970).

15. Policy issue here raised parallels the policy questions analyzed by this Court in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U. S. 723 at 737-749 (1975).

16. *Spielman* v. *General Host Corp.*, 402 F. Supp. 190, 203 (S. D. N. Y. 1975), quoting in part from *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F. 2d 341, 369 (2d Cir. 1973), *cert. denied*, 414 U. S. 910 (1973).

to walking across a minefield in which the slightest misstep means substantial liability" for the issuer.

Plainly the standard used must focus on the importance of the omission to the matter being submitted to the shareholders for their approval and the overall "false impression" generated by the omission rather than on the particular verbiage used to articulate the test of materiality. This is amply demonstrated by the SEC's Brief. The SEC accepts the "significant propensity test" as articulated in *Mills* and presumably rejects the broader test adopted by the Seventh Circuit. (SEC Br. pp. 9, 13, 15) Yet, at the same time, it concludes that the alleged omissions caused the Proxy Statement to violate Rule 14a-9.[17]

While Petitioners have regarded the "significant propensity" test as an appropriate statement for the rule of materiality, implying as it appears to do the importance of the facts omitted, the misreading of that standard by the SEC, with all its prestige in the field, shows there is need for this Court to use clearer and stronger language so as to emphasize that only the omission of facts of critical and vital consequence to shareholders' decision renders a proxy statement misleading.[18] We have no formulation which we can urge on the Court to carry conviction to the SEC and the plaintiffs' bar that minor matters are not enough. Petitioners cannot say whether the words should be *vital, critical, obviously determinative*, or whether some other stronger phrase is more appropriate to this purpose. Manifestly, it should be stated in clear and unmistakable language

17. SEC Brief pp. 4, 17-24.

18. The Seventh Circuit, in its rejection of the "significant propensity" test showed, we think, a better understanding than does the SEC's Brief of its intended meaning. The Seventh Circuit apparently felt that it was unable to accept the contentions which the SEC made in that Court that the proxy statement was materially false and misleading under that test. It therefore adopted a broader test which the SEC in its Brief now appears to reject because it may require "furnishing large quantities of trivial information." Hence the need noted above for specific guidance in language not susceptible of misunderstanding by those desiring to stretch the statute.

that a heavy burden exists and that the fact omitted, because of its obvious significance, almost certainly would have turned the shareholders' vote the other way.

II.

IN THIS COURT NATIONAL IS NOT IN CONTROL OF TSC; HENCE, CIRCUMSTANTIAL EVIDENCE ARGUED AS TENDING TO INDICATE CONTROL IS NOT MATERIAL AS A MATTER OF LAW AND CANNOT RENDER THE DISCLOSURES MADE FALSE OR MISLEADING. IN ANY EVENT, SUCH OMISSIONS ARE IMMATERIAL AND INSIGNIFICANT.

(Reply to Respondent's Brief pp. 36-39, 47-61 and SEC Brief pp. 13-15, 21-23.)

Northway persists in raising a specter of National's alleged control of TSC, despite the fact that both the District Judge[19] and the Court of Appeals,[20] found that the alleged control of National over TSC was not established in the summary judgment record.

The Seventh Circuit's analysis of the facts relating to National's alleged control of TSC involves three steps. First, the court below concedes that no finding may be made on the issue of control, stating that "control is a factual issue presently in dispute." Second, the court finds that the omitted facts are "persuasive indicators . . . [of] control." Third, the court concludes that Rule 14a-9 has been violated because the offerees are entitled to know facts which indicate "a substantial likelihood . . . [of] control."[21]

Underlying the court's analysis of this set of facts is the proposition that Rule 14a-9 requires disclosure of suggestive facts concerning control without regard as to whether there

19. 361 F. Supp. at 111-112.
20. 512 F. 2d at 329.
21. 512 F. 2d at 329, 332-333.

actually was control. This same error in analysis is clearly demonstrated in the court's discussion of alleged manipulation where the court indicated that the purpose of Rule 14a-9 is to give stockholders facts on which they can speculate:

> ". . . the purpose: of 14a-9 is to allow stockholders to draw such inferences as they see fit. . . . It was for the shareholders to determine . . . whether the activities of Madison and National actually amounted to manipulation at all." 512 F. 2d at 336.

The Seventh Circuit's position that Rule 14a-9 requires disclosure of suggestive facts without regard to the actual state of affairs represents a basic misunderstanding of the disclosure policies underlying the Rule. The defects in the court's interpretation of Rule 14a-9 can be analyzed as follows.

On one hand, the disclosure of suggestive facts is not sufficient to satisfy the obligation of full disclosure imposed by Rule 14a-9. If there are material facts which are important to investors, the Rule requires that investors be told clearly and completely about such facts. It is not sufficient to insert suggestive facts and "allow the shareholders to draw such inferences as they see fit." Thus, if the market price of National's stock was in fact manipulated, such manipulation should have been made clear in the merger proxy. The obviousness of this point can be demonstrated by hypothesizing a situation in which the manipulation was proved as a fact and an investor sued National on the ground that such manipulation was not adequately disclosed. It would be absurd to suggest that National could successfully defend on the ground that it had no obligation to make clear that manipulation existed but rather was only required to disclose facts (*i.e.*, the purchases) which suggested manipulation, with the burden of discovering such facts and drawing the correct inference therefrom being on the investor.

On the other hand, the disclosure of suggestive facts without regard to the actual state of affairs could violate the obligation imposed by Rule 14a-9 to avoid misleading statements.

If the actual state of affairs is contrary to that which the suggestive facts would seem to indicate, a company could be liable for misleading an investor. The possibility of such liability may be demonstrated by hypothesizing a situation in which it was proven that National did not control TSC and an investor sued alleging that he voted against the TSC transaction on the ground that he believed (on the basis of Yarmuth's and Simonelli's board titles and the 8-K disclosure) that National exercised control over the TSC board's recommendation. It would be absurd to suggest that National could successfully defend on the ground it was obligated under Rule 14a-9 to include facts which mislead the investor by suggesting "a substantial likelihood . . . [of] control" even though there was no control.

The analysis in the two preceding paragraphs indicates that the court's interpretation of Rule 14a-9 was erroneous. If the Seventh Circuit had applied a proper interpretation of Rule 14a-9 to the facts, it would have reached different results and found that the omissions were not misleading. As indicated above, a correct reading of the full and fair disclosure requirements of Rule 14a-9 requires full disclosure of the actual state of affairs without the inclusion of statements which could be misleading. Indeed the obligation not to mislead imposed by Rule 14a-9 indicates that there was a duty to omit facts merely suggesting manipulation or control.

A. Prior SEC Filings Were Not Significant.

(Replying to Respondent's Brief pp. 52-61 and SEC Brief pp. 21-23.)

In opposing the Petition and again in its Brief Northway has argued that control over TSC should be inferred from the February and March 1969 periodic reports to SEC made by National and TSC when the Schmidt family's control of TSC ceased upon the resignations of Charles Schmidt and his son following the sale of all of their stock to National (Resp. Br. pp.

53-61). The TSC 8-K had to be filed when Schmidt's control had ceased. National was required under Section 13 of the 1934 Act to file a Form 13-D when it acquired more than 10% (now 5%) of the voting securities of TSC. These were the obvious facts that triggered the reports and each report contained the stylized recital that National "may be deemed to be a parent of TSC."

The courts below both rejected Northway's contention, in its motion for summary judgment, that the Proxy Statement violated Rule 14a-3 in that it failed to disclose that National controlled TSC, holding that "the issue of control is a factual issue presently in dispute." 512 F. 2d at 329. Northway's contention seems to be that the "parent" statement contained in the SEC filings had to be disclosed, nevertheless, because it suggested the possibility of such control and thus might affect the independence of the TSC board's recommendation.

The Proxy Statement disclosed, as required by the proxy rules, that National owned 34% of the TSC stock, that no other shareholder owned more than 10% of the TSC stock and that five out of ten TSC directors were National nominees (A. 267-268). These required disclosures clearly indicated to the shareholders of TSC that National might have been in a position to exercise some degree of influence over TSC. The addition of the reference to the SEC filings would have done little, if anything, to add to a shareholder's awareness of National's possible influence over TSC.[22]

22. The SEC's Division of Corporate Finance which examined the Proxy Statement must, of course, have been fully aware of the prior periodic filings reciting that National "may be deemed to be a parent" of TSC, and its letter of comment dated November 10, 1969 (A. 96-100) made no suggestion that reference should be made to the fact that this statement was contained in the prior filings, which it plainly would have had it believed that such a disclosure was required or even desirable. The lower courts have consistently held that where facts are within the knowledge of the SEC, by reason of separate filings or otherwise, weight will be given to the judgment of the SEC staff not requiring their disclosure. See *e.g.*, *General Time Corporation* v. *Talley Industries*,

Furthermore, as discussed above, the terms of this particular transaction were in fact determined by Mr. Noyes, a TSC director and a partner of Hornblower, TSC's investment banker, and not by National, and were approved in that form by the unanimous vote of four independent directors with National's nominees abstaining.

Viewed in context of the prominent and plainly stated disclosures of National's equity interest in TSC and the presence of five National nominees on TSC's ten-man board (A. 267-268) and the actual absence of influence with respect to the terms of the transaction, it is idle to suggest that an explicit reference to the "may be deemed a parent" language in the prior SEC filings was so essential to fair disclosure that its omission caused the statement that the TSC board had approved and recommended the transaction to convey a false impression to the reasonable TSC shareholder.

B. The Board Titles of Yarmuth and Simonelli Were Insignificant.

(Replying to Respondent's Brief pp. 36-39, 47-50 and SEC Brief pp. 21-23.)

The Proxy Statement states that the TSC board approved the transaction and recommended its approval by the shareholders (A. 267). There is no dispute here that the TSC board took this action by the unanimous vote of only four non-National directors, and that none of National's nominees voted. The four independent directors acted on the basis of an opinion given to the board by Hornblower, an independent and competent investment banking firm. 512 F. 2d at 337.[23]

Inc., 403 F. 2d 159, 163 (2d Cir. 1968), *cert. denied*, 393 U. S. 1026 (1969); *Union Pac. R. R. Co.* v. *Chicago & N. W. Ry. Co.*, 226 F. Supp. 400, 406-407 (N. D. Ill. 1964). See also *J. I. Case Co.* v. *Borak*, 377 U. S. 426, 432 (1964).

23. One non-National director also abstained because of his recent sale of TSC stock to National for cash and notes payable over five years.

Nonetheless, Northway contends that the disclosures of the TSC board's action and recommendation of the transaction were seriously misleading because the Proxy Statement did not disclose that Mr. Yarmuth was Chairman of the TSC board of directors and that Mr. Simonelli was Chairman of the TSC board's Executive Committee.[24] Northway argues these additional disclosures were required to show National's potential of influence over TSC.

The Proxy Statement did, of course, prominently (1) disclose that five out of the ten TSC board members were National nominees; (2) identify all members of the TSC board; and (3) specify which were the National nominees and the position which they held in National (A. 267-268). This Proxy Statement disclosure stated that "[a]t the request of National, Mr. Stanley R. Yarmuth, President and director of National, Mr. Charles F. Simonelli, Executive Vice President and a director of National were . . . elected directors of TSC." (A. 267). Particularly when viewed in the light of the lower court's failure to find National controlled TSC, the omission of the titles[25] which Messrs. Yarmuth and Simonelli held on the TSC board plainly does not make the statements made regarding the affirmative recommendation of the TSC board misleading in any respect.

The Proxy Statement revealed the presence on the TSC board of the top executives of its 34% shareholder. This was the important fact and, under all the circumstances, the shareholders' knowledge of National's position of influence at TSC could hardly have been increased to any significant extent by the addition of these titles. Even the relevance of these titles was

24. Resp. Br. pp. 39-45.

25. Yarmuth never acted as TCS's chief executive (A. 105-106); his role as its new board Chairman was plainly shown in TSC's quarterly report to shareholders in September 1969 (A. 493-496). There is no evidence the TSC Executive Committee had any part in the transaction and National's nominees, Yarmuth and Simonelli, had a minority role on the committee which was dominated by old TSC directors Noyes, Schaefer and Sharfman (A. 471-472).

diminished by the fact that on the resolutions adopted on October 16, 1969, recommending the transaction described in the Proxy Statement, all of the National nominees, including Messrs. Yarmuth and Simonelli, abstained from voting (A. 414).

Northway denigrates abstention by National's nominees, because three of the four directors who did vote were employed by TSC which Northway's lawyers suggest put them under National's domination and made them subservient to National.[26] As evidenced by Schaefer's testimony (A. 182, 196-198) and Affidavit (A. 101-102), no such domination actually existed. The relationship of each of these three directors to TSC was prominently disclosed in the Proxy Statement (A. 268). The fourth favorable vote on the resolutions was Noyes, the investment banker who proposed the terms of the transaction on behalf of TSC and whose proposal was accepted by National without any negotiation (A. 155-156, 413). It is plainly foolish (if not materially misleading) to argue that Noyes was under National's control. He negotiated the favorable exchange ratio on behalf of TSC's shareholders. It was Noyes who formulated the counter-offer which National accepted.

On this summary judgment record those four TSC directors were free of any domination by National. Their recommendation to TSC stockholders to vote in favor of the transaction was untainted by any conflict of interest.

C. Mills Facts Were Critically Different.

(Reply to Respondent's Brief pp. 50-61 and SEC Brief pp. 11-17.)

Northway argues the judgment of the court below was required by this Court's decision in *Mills*[27] because "the controlling facts in *Mills* are directly matched by the facts here."

26. Resp. Br. pp. 45-47.

27. *Mills* v. *Electric Auto-Lite Co.*, 396 U. S. 375 (1970), *reversing in part*, 403 F. 2d 429 (7th Cir. 1968), *reversing*, 281 F. Supp. 826 (N. D. Ill. 1967).

(Resp. Br. p. 51). SEC chimes in, although it tinkers with the *Mills* text (SEC Br. pp. 13-15). Each argument ignores issues of material fact in this summary judgment record and thereby strays outside the principles stated in *Mills*. In *Mills*, control of the merging company was undisputed; here, control is disputed and both lower courts found it was not established. Accordingly, on the summary judgment record before this Court, National must be assumed not to have been in control of TSC.

Judge McLaren saw obvious and compelling differences between the facts disclosed in the summary judgment record before him (361 F. Supp. at 112-113) and the facts which were analyzed in some detail by the Seventh Circuit in *Mills* (403 F. 2d at 432-434). This Court regarded materiality of the proxy statement deficiencies in *Mills* as being conclusively established below.[28]

The key defect in the *Mills* proxy statement was that it stated that the board of directors of the merging company, Auto-Lite, recommended the transaction to its shareholders but failed to adequately inform them of the "relationship between the directors and the other party to the bargain." There was no disclosure in that proxy statement that seven of the eleven Auto-Lite directors were nominees of Mergenthaler (the acquiring company) and American (its parent) or that the four remaining Auto-Lite directors were kept on as window dressing by Mergenthaler, which was "the other party to the bargain."[29]

Page 2 of the *Mills* proxy statement spelled out in bold type that the board of directors of Auto-Lite believed the merger to be "fair and equitable to the shareholders of Auto-Lite." Buried on page 23 of that same proxy statement was an inadequate disclosure that four of the eleven Auto-Lite directors were also directors of Mergenthaler. Completely concealed from the Auto-Lite shareholders was the undisputed fact that Mergenthaler and American enjoyed and exercised effective day to

28. 396 U. S. at 381, n. 4.

29. 403 F. 2d at 433-434.

day, working control of Auto-Lite[30] for some time preceding the date of the proxy statement, and that seven of the eleven Auto-Lite directors were Mergenthaler nominees.

In sharp contrast to *Mills*, the Proxy Statement herein grouped together on pages 6 and 7 (A. 267-268) under bold-faced headings statements of approval of the transaction by both boards of directors, coupled with full statements of the substantial equity interest of National in TSC, National's five nominees of TSC's ten-man board of directors and the essence of the proposed transaction, all in understandable, equally prominent, direct language.[31]

National's alleged control of TSC is hotly disputed on this record. *A fortiori*, the Investment Company Act exemption National obtained in 1964 was wholly unrelated to its relationship to TSC in 1969.[32]

30. Effective working control of Auto-Lite by American through Mergenthaler was proved to the satisfaction of SEC which exempted American from provisions of the Investment Company Act of 1940 because it had and exercised such complete control.

31. The District Judge found (361 F. Supp. at 113):

> "Unlike the proxy statement dealt with in *Mills*, the joint proxy statement complained of here gives similar emphasis to the board's recommendation, National's equity interest in TSC, and the number and some of the positions of National's nominees. If the TSC shareholders were misled as to National's relationship to TSC, the circumstances under which this occurred can hardly be compared to the total concealment of the conflict of interest in *Swanson*."

32. This exemption is unrelated to TSC and National's relationships to TSC. National's Investment Company Act exemption related to companies a portion of whose securities National owned in 1964, five years before National bought Schmidt's TSC stock in 1969. By 1969, when National first acquired stock and later obtained board representation in TSC, exemption from the Investment Company Act was no longer of interest to National because the nature of National's assets had completely changed and National's investments in securities of other companies had fallen far below the 40% benchmark found in the "investment company" definition.

III.

OMISSION OF REFERENCE TO THE HORNBLOWER OPINION ON VALUE OF NATIONAL'S WARRANTS WAS NOT MATERIAL.

(Reply to Respondent's Brief pp. 12-24 and SEC Brief pp. 20-21.)

Northway argues and the Court of Appeals held that the Proxy Statement:

(a) disclosed market prices of securities involved in the transaction, including National's warrants, quarterly and on November 7, 1969;

(b) stated the factors considered by Hornblower which included ". . . the substantial premium over current market values represented by the securities being offered to TSC stockholders.";

(c) did not disclose Hornblower's opinion of a $3.50 value for warrants, "subsequently rendered"; and

(d) was therefore false and misleading because TSC stockholders who relied on the Proxy Statement were led to believe the current market values disclosed therein were accurate indicators of the specific "profit" to be generated for them in the exchange, which was not true.[33]

Hornblower rendered a favorable opinion as to the fairness of the transaction to the stockholders of TSC. This fact and identification of five factors considered by Hornblower in reaching its opinion are spelled out on page 6 of the Proxy Statement (A. 267):

> "In such opinion, said firm considered, among other things, the current market prices of the securities of both corporations, the high redemption price of the National Series B preferred stock, the dividend and debt service requirements of both corporations, the substantial premium over current market values represented by the

33. 512 F. 2d at 334-335.

> securities being offered to TSC stockholders, and the increased dividend income."

Though fully aware that Hornblower considered many factors in reaching its favorable opinion on fairness of the transaction, the Seventh Circuit fastened on just one factor: A "substantial premium over current market values represented by the securities being offered to TSC stockholders."[34]

Next the court below strung a thin thread of inference from page 6 of the Proxy Statement, where the directors' approval, Hornblower's opinion, National equity interest in TSC and National's nominees on TSC's board are disclosed fully and fairly, to page 10 of the Proxy Statement, where the required disclosure of recent market prices of all securities of both corporations are set out along with the November 7, 1969 closing prices of the securities involved in the transaction.

With no visible means of support in the Proxy Statement, the court below nevertheless found that the Proxy Statement linked up the evaluation of the proposed exchange to the current market values shown in the table of market prices and "invited shareholders to rely on a table of market values. . . ." Then the court used its own "simple arithmetic" to determine the specific and substantial premium which it found the Proxy Statement invited shareholders to rely upon and which it characterized as the "profit" to be generated by the exchange being proposed.[35] The court also fostered the novel inference that the Proxy Statement led the shareholders to believe that Hornblower considered current market values disclosed in the proxy to be accurate indicators of the profit they would realize.

Having isolated one factor considered by the investment banking firm and linked it to a portion of a full page of market price information four pages later in the Proxy Statement, the court below concluded that a Hornblower opinion of a $3.50 intrinsic value of the warrants should have been disclosed.

34. 512 F. 2d at 334, n. 16.

35. 512 F. 2d at 335.

SEC also argues that the prices shown for National warrants in the table on page 10 were rendered materially misleading by the failure to disclose the $3.50 opinion on value of the warrants and comments (at page 21):

> "This data was materially misleading because it did not disclose that the Hemphill, Noyes firm had *subsequently* advised management that it expected that the market value of the National warrants included in the package would decline substantially subsequent to the proposed exchange." (Emphasis added)

Both the Seventh Circuit in writing its opinion (512 F. 2d at 335) and Northway in its argument in this Court foster and then rely upon two fictions. Each fiction readily disappears upon examination of the summary judgment record. *First,* Noyes' opinion on value (which is not the same as market price) was neither later or subsequent to, nor inconsistent with, the current market prices of all securities (including the warrants at 5⅜ in early October 1969) of which Noyes as an experienced investment banker, an important stockholder and director of TSC, was well aware. As noted herein at pp. 6-7, 27-28, his opinion of intrinsic value was used in negotiations with the representatives of National by Noyes himself in a series of meetings between October 2 and October 9, 1969 as a basis for raising the exchange ratio above that proposed by National in order to provide a premium over current market prices of the TSC securities.

Second, the rise in price of the TSC securities from mid-October to November 7, 1969 as a result of the favorable exchange ratio becoming public knowledge, which gave the marketplace an opportunity for arbitrage profits,[36] is wholly ignored by both the court below and Northway in making their calculations as to the premium afforded by the package of National securities

36. The key role which arbitrageurs play in price and volume of publicly traded securities on the moment of important news is well explained in "Ruthlessness by the Rules," FORBES, February 1, 1976, Vol. 117, No. 3 at pp. 24-25.

over corresponding TSC securities prices on November 7, 1969, a month after the exchange ratio was formulated and more than two and one-half weeks after the favorable exchange ratio had become public knowledge.

Noyes' $3.50 opinion on intrinsic value of the warrants was neither subsequent to his October 16th opinion and report to the TSC board on the fairness of the transaction to the TSC stockholders, nor inconsistent with the evaluation which Noyes and his firm had made of the entire transaction from the point of view of the shareholders of TSC, giving due regard to a variety of factors including the current market prices of the securities of both corporations.

Identification and isolation of these fictions explains why the calculations made by Northway (Br. pp. 12, 14) with respect to the disappearance of the "substantial premium" are erroneous. Northway's calculations begin with the second fiction noted above. Northway ignores the substantial rise in the price of TSC securities from the period when the exchange ratio was determined (October 9) to the November 7, 1969 date; namely, that TSC preferred moved up from $11 to $12 while TSC common increased from 11⅝ to 13¼. *Instead of being deprived of a promised profit, TSC shareholders had actually already realized in the market price of their securities*[37] *a portion of the premium over current values of which Noyes wrote and spoke before the Proxy Statement was mailed to them on November 12, 1969!*[38]

37. Many of the reasons for not requiring disclosure of an opinion on value of one of several securities involved in a transaction where there are current market prices available as to all of them for the entire relevant period are indicated in Petitioners' Brief at pages 37-39.

38. Compare the Court of Appeals statement that the Proxy Statement linked evaluation of the proposed exchange to current market values and "invited shareholders to rely on a table of market values . . .", 512 F. 2d at 334, with the District Judge's analysis of these aspects of the summary judgment record, 361 F. Supp. at 116, where he comments that there is no evidence in the record to support Northway's claim that the Hornblower firm relied on a $3.50

When Hornblower made both its analysis and evaluation of the fairness of the proposed transaction to TSC shareholders and its counterproposal of an improved exchange ratio to National's representatives, the "current market values" of which Hornblower spoke in its October 16, 1969 letter to the TSC board on fairness of the transaction were early October prices.[39] Necessarily, Hornblower looked to a market price on National Series B preferred at $16 (A. 160); later it closed higher on November 7, 1969 at $16⅝ (A. 271). In early October the market price for the TSC common stock was $11⅝ (A. 159); it closed higher on November 7, 1969 at $13¼. Hornblower worked with a market price for the TSC preferred stock of $11 (A. 160); later it closed higher on November 7, 1969 at $12.

Hornblower worked with two assumptions on National's warrants (A. 149-150, 156-157): (1) the warrants' price was $5⅜ on the public market in early October, 1969; and (2) the warrants (including 2.6 million to be issued in the exchange) were intrinsically worth $3.50 as of October 9, 1969 (A. 155-156). As an experienced investment banker, Noyes avoided forecasting any substantial future profit to TSC stockholders.[40] He knew only too well that whether any resultant premium to TSC shareholders on December 5, 1969 could fairly be described as "substantial" could only be determined at that later point in time long after the marketplace's early reaction to the proposed transaction.

In negotiations with National on behalf of TSC, Hornblower and TSC director Noyes at all times assumed a $3.50 intrinsic warrant value. It was on that assumption that the Hornblower

value of the warrant *and* that use of that figure results in a very small premium, rather than the substantial one claimed.

39. A. 427.

40. There was no prediction of future market values in the Proxy Statement. Such predictions are proscribed by Rule 14a-9 and would have drawn angry comment from SEC staff who reviewed the document. No such comment was made here.

firm influenced the exchange ratio in favor of TSC and concluded that the proposed transaction was fair to the TSC shareholders (A. 155-158, 413). At the same time Mr. Noyes stated that it was "inadvisable in the securities business to argue with market evaluation" and that we "never ignore it." (A. 156.)

The Premium Was There.

There actually was a substantial premium in the package of National securities offered to the TSC shareholders under the October 9, 1969 exchange ratio, using Noyes' $3.50 opinion on value of National's warrants and then-current market values for all other securities involved in the transaction. The presence of a 19% premium for TSC preferred stockholders and a 14% premium for TSC common stockholders as of October 9, 1969 is shown below:

Premium to TSC shareholders on October 9, 1969 using Noyes' $3.50 intrinsic value for warrants and current market values for all other securities.

As of October 9, 1969	TSC Preferred	TSC Common
National B Pfd (at 16)	$ 9.60 (.6 sh.)	$ 8.00 (.5 sh.)
National Warrant[41] (at 3.50)	3.50	5.25 (1½ war.)
Total	13.10	13.25
Less TSC Market (pfd. 11) (com. 11⅝)	11.00	11.63
Premium	2.10	1.62
Premium of package of National securities (warrant at $3.50 intrinsic value) over current market values of TSC securities on October 9, 1969, the day the exchange ratio was set, expressed as a percentage	19%	14%

41. Market price was $5-3/8.

If the October 9, 1969 market value of the National warrants, 5⅜, is used rather than the $3.50 intrinsic value, the bottom line of the above chart would read "36%" with respect to the TSC preferred and "38%" with respect to the TSC common.

Between October 9, 1969 and November 7, 1969 (the last date for which current market prices were shown in the Proxy Statement at page 10) the price of TSC preferred rose from $11 to $12 while TSC common rose from $11⅝ to $13¼, possibly because of arbitrage once the favorable exchange ratio became public knowledge.[42] Hence a portion of the premium over current market prices of the TSC securities as they existed on October 9 had already been realized before the Proxy Statement was mailed to the holders of TSC on November 12, 1969.

The Proxy Statement market prices table actually invited a shareholder to look at the high and low market prices by calendar quarters for the years 1967, 1968 and 1969 (through November 7, 1969) and gave closing prices for the securities directly involved in the transaction at November 7, 1969.[43] The table below shows what the Proxy Statement revealed to the TSC stockholder who studied page 10 (A. 271) and made his own arithmetic calculations.

42. In the same period of time prices of National securities involved in the transaction changed very little. National Series B preferred increased from $16 to $16-5/8 while National's warrants, which were the other part of the package, declined in market price from $5-3/8 to $5-1/4.

43. A. 271.

Premium to TSC shareholders on November 7, 1969 using then-current market values for all securities as reported at page 10 of Proxy Statement (A. 271).

As of November 7, 1969	TSC Preferred	TSC Common
National B Pfd. (at 16⅝)	$ 9.98 (.6 sh.)	$ 8.31 (.5 sh.)
National Warrant (at 5¼)	5.25	7.88 (1½ war.)
Total	15.23	16.19
Less TSC Market[44] (pfd. 12) (com. 13¼)	12.00	13.25
Premium	3.23	2.94
Premium of package of National securities over current market prices of TSC securities on November 7, 1969, expressed as a percentage	27%	22%

The federal securities laws do not and should not require a proxy statement to spell out underlying assumptions as to value, formulas for calculating intrinsic values or negotiating techniques the investment bankers used in evaluating the various factors considered in arriving at their opinion and advice to the TSC board that the terms of the proposed transaction were "fair and equitable" to the TSC shareholders (A. 427-428).

Noyes' statement to his fellow TSC directors that there might be "some decline in the price of the warrants" was coupled with his express recognition and description of other important factors, all of which led to his opinion that "the exchange offer is a fair one" (A. 413). This was a responsible professional opinion which remained unaltered and was reiterated even after

44. December 5, 1969 closing prices of securities exchanged in the transaction were:

National Series B Preferred: $12-1/4
National Warrants: $4.00
TSC Common: $11-3/8
TSC Series 1 Preferred: $11.00

issuance of the Proxy Statement (A. 429). The Seventh Circuit imprudently and erroneously characterized the Hornblower assumption of a $3.50 warrant value as "bad news" when, in fact, it was really no news at all!

If opinions on intrinsic value (as contrasted with market price) of securities must be spelled out in a proxy statement, what about all of the other unexpressed judgments which necessarily were made to arrive at an opinion in October on the fairness of a transaction to take place in December?[45] What about the Hornblower firm's assumptions and consideration of the market prices of the securities of "both corporations?" What about the "high" redemption price of the National preferred, part of the package appraised as a "sound value?" (A. 413) What about the dividend and debt service requirements of "both corporations?" What about the "increased dividend income?" (A. 267, 427-428) Should the federal courts require elaboration and amplification of the professional analysis of all of these kinds of factors in a proxy statement? Finally, under the yardstick of Rule 14a-9, which of all such unexpressed assumptions can be determined to be so important that its omission renders the Proxy Statement itself false or misleading in a material respect?

The summary judgment record discloses that the honest and correct opinion of the Hornblower firm at all relevant times was that the proposed transaction was fair to the TSC shareholders (A. 427-429). The court below discovered a prediction of "profit" to be generated in the transaction, though no such forecast of future price or profit can be found in the plain print of the document. In furtherance of its conclusion the court below refused to recognize either the purpose or plain meaning of Noyes' letter to National (A. 519). The Seventh Circuit improperly and unnecessarily drew a biased, unfavorable in-

45. If the assumption of a $3.50 value for the warrants must be spelled out in the Proxy Statement, presumably full disclosure would also require parallel disclosures of opinions on the value (not market price) of other securities in the transaction.

ference and concluded that the Hornblower firm's true opinion was different, important and wrongfully withheld from TSC's shareholders. 512 F. 2d at 335. That prejudicial choice among several reasonable inferences by a reviewing court on a summary judgment record is simply inexcusable.

There actually was a "substantial premium over current market values" for the TSC shareholders. Noyes' use of a $3.50 intrinsic value of the warrants in evaluating the October 9, 1969 exchange ratio built in a conservative margin to cushion the probable market price impact of 2.6 million additional warrants which were to be issued upon approval of the transaction two months later. Otherwise, the favorable exchange ratio might have been thrown out of balance. Only by skipping over Noyes' testimony and supplying to the Proxy Statement predictions by the Hornblower firm of future market prices, was the court below able to surmise and infer enough to conclude that Noyes' opinion to National on the value of the warrants had to be disclosed in order to avoid making the table of market prices on page 10 of the Proxy Statement misleading as a matter of law.

The only proper inference, if any, to be drawn should have been adverse to Northway as the moving party and in favor of National and TSC against whom the motion was brought. *Adickes* v. *S. H. Kress & Co.*, 398 U. S. 144 (1970). That reasonable and plausible inference was that the opinion stated in Noyes' letter of October 31, 1969 was wholly consistent with, supportive of, and therefore fairly disclosed by, the Hornblower firm's previously expressed opinion and advice to the TSC board that the terms of the proposed transaction were "fair."

IV.

OMISSION OF REFERENCE TO MADISON FUND'S PURCHASES OF NATIONAL SECURITIES AND THE METHOD OF DISCLOSING NATIONAL'S OWN PURCHASFS OF ITS COMMON STOCK WAS NOT MATERIAL.

(Reply to Respondent's Brief pp. 24-36 and SEC Brief pp. 17-20.)

Despite Northway's repeated innuendo and insinuation of a "Madison-National" relationship and frequent reference to common stock purchases by "Madison and National," there is no direct evidence of any stock price manipulation by anyone. In fact the record shows otherwise. SEC unfairly characterized Madison as a "closely allied mutual fund" (SEC Br. p. 7) which had purchased National's convertible debentures and common stock in the market. Plainly Madison was not an "affiliate" of National[46] and, under the circumstances, there was then and is now no specific item in the proxy rules which would have required disclosure of Madison's purchases of National's common stock and debentures, securities which were *not* involved in the transaction with TSC in 1969.[47]

Although there is no evidence in this summary judgment record that all or any of such purchases had any effect on the market prices of National's common stock or on the National securities that were exchanged for TSC's stock, SEC's lawyers speculate at page 10 of their Brief that Madison's purchases of National's common stock "*may* (emphasis added) have affected

46. An "affiliate" is defined in SEC Rule 12b-2(a) as:

"(a) *Affiliate* an 'affiliate' of, or a person 'affiliated' with, a specified person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified." 17 C. F. R. § 240.12b-2(a).

47. Nothing in Schedule A to Rule 14(a) requires any such disclosure of securities transactions by Madison Fund on the facts in this summary judgment record.

that data," *i.e.*, market prices of all National and TSC securities shown at page 10 of the Proxy Statement (A. 271). Then, apparently warming to the task of finding some Rule 14a-9 violations (no doubt to vindicate their Amicus Brief in the court below), the SEC Brief pontificates (at page 20):

> "In any event, there was not even minimal disclosure of the purchases by the Madison Fund or of the relationship between that fund and National. Although recent market prices of the company's securities were required to be disclosed by Schedule 14A of the proxy rules, 17 C.F.R. 240.14a-101, this did not justify the failure of management to disclose with equal prominence market transactions by National and Madison Fund which *necessarily affected these prices*." (Emphasis added)

SEC's comments are little else but rank speculation on what might have happened. They are neither supported nor inhibited by any evidentiary facts in the summary judgment record. The SEC's lawyers are not expert witnesses whose opinions on the mechanisms of the public securities markets can be added to the record in this Court.

The Seventh Circuit's analysis of the omission of facts relating to market purchases by National and Madison Fund is essentially identical to its analysis of the omissions relating to National's alleged control over the management of TSC. The court's analysis of the market purchases involves three steps. First, the court concedes that the question of market manipulation is still open. It makes no findings as to the existence of manipulation. Second, the court finds that on the basis of the facts, manipulation "is certainly suggested." Third, the court finds that Rule 14a-9 has been violated because the offerees "must be informed of circumstances which tend to indicate . . . market manipulations."[48]

The flaw in the Seventh Circuit's analysis is its belief that Rule 14a-9 requires disclosure of suggestive facts concerning manipulation and control without regard as to whether there

48. 512 F. 2d at 336, quoted herein at p. 15.

actually was manipulation or control. This proposition is clearly demonstrated in the court's discussion of manipulation where the court indicated that the purpose of Rule 14a-9 is to give stockholders facts on which they can speculate.[49]

The court's position that Rule 14a-9 requires disclosure of suggestive facts without regard as to the actual state of affairs represents a misunderstanding of the disclosure policies underlying the Rule. The defects in the lower court's interpretation of Rule 14a-9 are analyzed above at pages 14-16 of this Reply Brief.

Whether Madison Fund purchases of National common stock and convertible debentures (neither of which was involved in the proposed transaction) were somehow coordinated or in concert with National was sharply disputed by Opposing Affidavits; summary judgment treatment was thereby precluded under Rule 56. The District Court correctly recognized the importance of this.[50] The Seventh Circuit erred.[51]

As noted in our brief restatement of the decisive facts,[52] National's common stock was *not* involved in the transaction. TSC shareholders received principally National preferred stock and some National warrants. Moreover Northway does not even claim to have any evidence establishing, for purposes of its summary judgment motion, that the purchases of the mutual fund were coordinated with National.

Wholly speculative (SEC Brief p. 20) is the effect, if any, such common stock purchases may have had on the market price of National's common stock, which declined throughout 1969.[53] Notably absent too is any evidence of the effect of the

49. *Id.*, quoted herein at p. 15.

50. 361 F. Supp. at 115-116.

51. 512 F. 2d at 335-336. Contrast the analytical approach to summary judgment evidence and procedure taken by the District Court in 361 F. Supp. at 116 with the short shrift given Rule 56(c) and SEC Rule 14a-9 by the Seventh Circuit in 512 F. 2d at 336.

52. P. 8 of this Reply Brief.

53. A. 107-108 Graph.

market price of National's common on the price of National warrants which were to be issued in that transaction.

In these circumstances, Rule 14a-9 does not require disclosure of such purchases to enable stockholders to speculate as to the possible remote effect of such market transactions.

V.

UNEXPLAINED CONTRADICTION IN SEC's AMICUS POSITION.

(Replying to SEC Brief pp. 4-9, 17-24.)

SEC urged the court below to sustain some of Northway's claims on the motion for summary judgment and to reject others. Obviously impressed with the position of a government agency, the Seventh Circuit followed the suggestions of the SEC religiously: It rejected the allegations of control, which the SEC had said were not proved, and accepted as material those allegations, *e.g.*, the board titles of Yarmuth and Simonelli, which the SEC said had been proved sufficiently for summary judgment.

While the Seventh Circuit swallowed whole the SEC's recommendations, it recognized that in order to accept those recommendations it would have to apply lower standards of materiality than those which had been proclaimed by this Court and previously applied by other courts; this it was willing to do.[54]

SEC's suggestions, carrying with them the connotations of the impartial judgment of an expert body, were adopted in a manner not worthy of such construction. The SEC's argument was presented by those SEC lawyers having the least acquaintance with the field of disclosure, and with no knowledge of the processing of proxy statements including the present one.

The SEC's Briefs in the Seventh Circuit and in this Court set up some of the very same facts which the Division of

54. 512 F. 2d at 329-332.

Corporate Finance, four and a half years earlier, plainly did not consider to be sufficiently important to require disclosure. SEC's Division of Corporate Finance reviewed and "cleared" the Proxy Statement in the fall of 1969 without even suggesting the disclosure of any of the matters which counsel for SEC now regard as sufficiently material to make the Proxy Statement itself false and misleading.

The staff was obviously familiar with the prior filings stating that "National may be deemed to be a parent of TSC" and that Mr. Yarmuth was titular Chairman of the board of TSC. The Division's staff, however, in its letter of comment did not call for the disclosure of the prior filings or for any additional disclosures as to the potential National may have had for influencing the actions of the TSC board in recommending the approval of this transaction. Yet, SEC's Brief here makes a major point of the absence of any reference to the prior SEC filings.

This is very reminiscent of what happened in *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F. 2d 1281, 1291-1292 (2d Cir. 1973), where Judge Friendly said that positions taken by the SEC's Brief there "must have been as much a surprise to the Commission's branch chief [the Division of Corporate Finance official who reviewed the proxy statement there] . . . as it was to Skogmo's counsel." There is no explanation of why the SEC's Briefs take a viewpoint so diverse from that of the Division which has the primary responsibility for reviewing proxy statements and developing disclosure policies. The only clue offered in SEC's Brief (pages 23-24, n. 13) is that the staff was busy and was not aware of some of the facts. This may be true but it does not apply to the "may be deemed to be a parent" language which was before the staff in the current files. It is plain that the examiners in the Corporate Finance Division regarded the omission of reference to those prior required reports as appropriate when they reviewed the preliminary proxy statement.

The SEC's arguments as to whether the particular omissions made the Proxy Statement false and misleading should be entitled to little consideration. This Court observed recently that where there is an "unexplained contradiction in the Commission's position we accord no special weight to its views."[55] There is such an unexplained contradiction here between the action of the Division of Corporate Finance in "clearing" the Proxy Statement in 1969 and the SEC's Brief.

In this Court SEC's lawyers appear to reject the broader rule of materiality adopted by the Seventh Circuit but predictably repeat the same arguments as to the materiality of the omissions which were made in the Seventh Circuit. Despite what SEC's attorneys now feel free to say about materiality in their Brief (SEC Br. 13-16), the Commission itself in its comprehensive Release 34-11733[56] refers to the same SEC Rules Petitioners have cited (Pet. Br. 20-23) as pointing the way to a workable standard for determining "material information," namely: SEC Rules 405, 12b-2 and 14a-9(a). Indeed, the Release (40 Fed. Reg. 51659-60) says it well:

> "The weighing of these factors, among others, is the mechanism by which disclosure is rendered fair as well as full. In administering the disclosure process under the Securities Act and the Securities Exchange Act, the Commission has generally resolved these various competing considerations by requiring disclosure only of such information as the Commission believes is important to the reasonable investor—'material information.' 17 CFR 230.-450(1), 230.408, 240.12b-20, and 240.14a-9(a). This limitation is believed necessary in order to insure meaningful and useful disclosure documents of benefit to most investors without unreasonable costs to registrants and their shareholders."

55. *United Housing Foundation, Inc.* v. *Forman*, 421 U. S. 837, 858 n. 25 (1975).

56. File No. S7-593, Environmental and Social Disclosure, 40 Fed. Reg. 51656 (Nov. 6, 1975), which is the source for a significant part of Petitioners' Brief, pp. 18-24, subtitled: "Materiality is the Key in Disclosure Standards." This Release was issued on October 14, 1975.

In this Court SEC's lawyers doggedly replay the same tired tale they sold the Seventh Circuit. They ignore SEC's comprehensive October 1975 Release and leave litigants and proxy writers wondering whether SEC really has any position on materiality. Once again, there is this same frustrating "unexplained contradiction" between the current Release on materiality and the SEC's lawyers' rumblings.

In sum, the views of SEC's lawyers merit no consideration here.

CONCLUSION.

TSC and National respectfully urge that the decision and judgment of the Court of Appeals for the Seventh Circuit on liability of these Petitioners be reversed and that the judgment and Order of the United States District Court denying Respondent's motion for summary judgment as to liability of corporate defendants be reinstated.

Respectfully submitted,

JOSEPH N. MORENCY, JR.,
JAMES T. OTIS,
WESLEY S. WALTON,
JOHN R. F. BAER,
Keck, Cushman, Mahin
& Cate,
8300 Sears Tower,
233 South Wacker Drive,
Chicago, Illinois 60606,
312/876-3400,
Attorneys for Petitioners.

Of Counsel:
MILTON V. FREEMAN,
WERNER J. KRONSTEIN,
Arnold & Porter,
1229 Nineteenth Street, N. W.,
Washington, D. C. 20037.

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